Insights into structuring (JVs, REIT takeouts, co-GPs, etc.)

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JVs vary dramatically and can be structured to align interests of both parties.

Key Considerations

**Single Asset, Multi-Asset and Programmatic JVs**

### Incentive Fees
- Preferred return vs pari passu
- Core investments typically have single promote or “flat” preferred structure; sometimes IRR driven up to specific return, equity multiple thereafter
- Core+, value-add and opportunistic investments typically have a tiered waterfall structure based on IRR

### Non-Incentive Fees
- Acquisition / disposition fee
- Asset management fee
- Construction management fee (if applicable)
- Development fee (if applicable)
- Financing / refinancing fee
- Leasing Fee
- Property management

### Control
- Negative control
- No control
- Board seats
- Voting rights
The Venture
- 90/10 Limited Partnership / LLC formed to acquire off-market portfolio
- 10% General Partner with co-GP
- 90% Limited Partner
- The GP will be wholly owned and controlled by the Company
- 90/10 equity contribution of the 10% GP interest:
  - 10% Company
  - 90% co-GP

Co-GP Target Returns
- 20% net IRR and 2x equity multiple

Term
- 10 years

GP Distribution Waterfall
- 100% of cash flows from operations, sales and refinancings, net of fees and taxes, are distributed 90/10 pro rata until invested capital is returned and up to a 6% IRR per annum
- For an IRR per annum above 6% and up to 8%, 80% to co-GP and 20% to Company, pro rata
- For an IRR per annum above 8% and up to 10%, 65% to co-GP and 35% to Company, pro rata
- For an IRR per annum greater than 10%, 55% to co-GP and 45% to Company, pro rata

Key Considerations
- buy-sell provisions
- distributions
- exit requirements
- fees
- financial reporting
- governance
- leverage
- pursuit costs
- right of first refusal

Sector
- Multifamily

Geography
- San Francisco Bay Area
Company Share Deal

Recent EY-Led Transaction – Closed

Self-Storage Company

- Owns and operates approximately 78 self-storage properties nationally
- Sophisticated board and management with public company experience
- Funded by ultra high net worth families and a corporate line of credit
- Continue acquiring under-performing self-storage properties, re-branding the properties under their trade name
- The company sought equity capital into shares of the company via a private round of financing

Equity Raise

- $120 million private share issuance; placed with large international financial sponsor
- EYCA facilitated five of six term sheets received
- Varying, complex equity and debt structures
- Nuances around valuation, governance, exit, etc.
- Ran process from inception to close in October 2014

Equity Raise

- Class of shares
- Cash flow distribution priority
- Existing and future non-incentive fee payments
- Board seats / rights
- Investment and other committee seats / rights

Structuring

Company / Background

Ernst & Young Capital Advisors, LLC

Note: U.S. Real Estate Investment Banking services are offered by Ernst & Young Capital Advisors, LLC, a broker-dealer affiliate of Ernst & Young LLP. All other services are offered by Ernst & Young LLP.
DiamondRock’s Acquisition of a to be Constructed Hotel in Times Square

- DiamondRock Hospitality Company (the “Company”) enters into a purchase and sale agreement to acquire, upon completion, a 282 room hotel property under development in Times Square, New York City.
- Contractual purchase price ranged from $112.5m – $135m, depending on final number of rooms, or ~$450,000 per guest room.
- Fixed-price contract (which varies only by total guest rooms built and the completion date for the hotel).

- Upon entering into the purchase agreement, the Company made a $20m deposit. Upon the completion of certain construction milestones, the Company will make an additional deposit of $5m. If certain permits, approvals and consents necessary for the Hotel to contain more than 250 guest rooms are obtained, the Company will make an additional deposit of $45,000 per guest room for each room in excess of 250.

- DiamondRock’s acquisition of the hotel was subject to a variety of conditions, including substantial completion of the hotel by the third-party developer, construction of the hotel within the contractual scope (24 – 30 months) as well as the satisfaction of other customary closing conditions.

- The hotel was developed by an affiliate of Walton Street Capital LLC and Highgate Hotels, current operator of the property.

- DiamondRock did not assume any construction risk including the risk of construction cost overruns.

Key Considerations

- breach of contract
- construction risk
- delivery timeline
- fixed vs variable price contracts
- liability sharing
- performance deposits
Select Alternative Structures

UPREIT Unit Deal with Existing REIT Public or Private (listed or unlisted)

**Public Investors**

**Public REIT**

**Continuing Company LPs**

**Operating Partnership**

**Company Assets, Plus Existing Assets**

### Topics for Discussion
- Acquirer cash can buy out some existing Company GPs / LPs or retire debt tax efficiently
- REIT shares could devalue during hold; non-traded REIT restriction period may outweigh benefit of collecting GP fees (i.e., less liquid than traded REIT)
- Maintain management platform outside of REIT
  - May desire board seat(s)
  - Establish relationship for placing incubated assets in the future
  - Maintain other capital relationship (JVs, funds, etc.) in US and/or abroad
- May be appealing to mix assets and capture further upside in UPREIT, but depends on quality of other assets in the REIT, management and redemption rights
- May consider US and Canadian UPREIT structures and DOWNREIT structures

### Structural Considerations
- Continuing Company LPs become Operating Partnership unitholders, with customary rights to exchange units for REIT Shares in the future
- Acquiror cash or REIT shares can be used in part to buy out some existing Company LPs
- Acquiror cash also may be used to partially redeem some existing Company LPs
  - Cash generally taxable unless an exception to disguised sale treatment exists
    - Reimbursement of limited pre-formation capital expenditures
- Acquiror cash also may be used to retire existing Company debt on contributed properties
  - Potentially taxable as a disguised sale unless liabilities are "qualified"
- Tax-deferral should be possible for continuing Company LPs with no disguised sale treatment
  - Gain recognized when LPs exchange OP units for REIT shares
  - Gain recognized as Company Assets with deferred gain are sold and gain is specially allocated to Company LPs
  - "Tax Protection Agreements" to ensure a minimum deferral period are customary in OP unit deals
  - Discuss impact of allocated partnership liabilities
Select Alternative Structures

Joint Venture with US Partner

Topics for Discussion

- JV Partner cash can buy out some existing Company LPs but tax efficiency varies
- Maintain flexibility as a non-public or pre-public vehicle (less reporting, greater control depending on investor/structure, lower cost than IPO, etc.)
- Maintain control of management platform and possibly related management fees
- Less liquid than public market alternatives

Structural Considerations

- Continuing Company LPs become JV members, with liquidity rights at stated intervals, based on prescribed valuation methodology
- JV Partner cash can be used in part to buy out some existing Company LPs
- JV Partner cash also may be used to partially redeem some existing Company LPs
  - Cash generally taxable unless an exception to disguised sale treatment exists
  - Reimbursement of limited pre-formation capital expenditures
- JV Partner cash also may be used to retire existing Company debt on contributed properties
  - Potentially taxable as a disguised sale unless liabilities are “qualified”
- Tax-deferral should be possible for continuing Company LPs with no disguised sale treatment
  - Gain recognized when LPs exercise liquidity option
  - Gain recognized as Company Assets with deferred gain are sold and gain is specially allocated to Company LPs
  - “Tax Protection Agreements” to ensure a minimum deferral period are customary in joint ventures, but likely to be shorter than in the public market given JV partner’s likely exit considerations
  - Discuss impact of allocated partnership liabilities
- In a non-public JV, higher leverage is possible and debt-financed distributions may provide additional opportunities for tax-deferred cash payments to continuing Company LPs (i.e., “leveraged partnership”)
- Note: No REIT depicted here, but might be necessary if JV partner is tax exempt and subject to UBIT
Select Alternative Structures

Joint venture with non-government international partner

Topics for Discussion

- Implication of international partner(s) owning <50% (limitation on initial cash, expatriation, monitoring required, need for REIT structure)
- International Partner likely will require no or limited asset sales by REIT to minimize FIRPTA reporting and tax
- Likely exits are sale of entire portfolio through sale of REIT shares or IPO of REIT to US investors allowing International Partner to sell as selling shareholder or over time in the public market
- Discuss internalizing some or all of the management platform
- Consider long-term “fit” (cultural, governance, timing, ongoing source of capital, etc.)

Structural Considerations

- International Partner(s) own in the aggregate <50% of JV by value, so that underlying REIT is “domestically controlled”
  - Limits percentage of Company LP’s that can cash out initially and over time
  - Assumes all continuing Company LPs are US and remain US (no expatriations by current owners/beneficiaries of family trusts etc.)
  - International Partner may require a “cushion” of a few percentage points for the domestically controlled test
- Continuing Company LPs become JV members, with liquidity rights at stated intervals, based on prescribed valuation methodology, and subject to maintaining >50% US ownership during the investment period
- Should be possible to structure tax-deferred transaction for continuing Company LPs
  - Funds rolled up into JV
  - Foreign partner purchases interests from tendering JVs
  - Structure will address FIRPTA considerations to International Partner of these transactions
  - JV contributes all assets to REIT
- Discuss impact of allocated liabilities
Select Alternative Structures

Joint venture with international government(s)

Topics for Discussion

- Implication of Foreign Government ("FG") owning >50% (limitation on initial cash, monitoring required, need for REIT structure)
- International Government ("IG") likely will require no or limited asset sales by REIT to minimize FIRPTA reporting and tax
- Likely exits are sale of entire portfolio through sale of REIT shares or IPO of REIT to US investors allowing IG to sell as selling shareholder or over time in the public market
- Discuss internalizing some or all of the management platform for cash or JV interests
- Consider long-term "fit" (cultural, governance, timing, ongoing source of capital, etc.)

Structural Considerations

- IGs can own in the aggregate >50% so long as no one IG owns 50% by vote or value. The REIT need not be domestically controlled, but no IG can have control or effective practical control of the REIT. The JV itself cannot have any activity other than ownership of the REIT
  - May limit percentage of Company LP’s that can cash out initially and over time. Limitation will be less if more IGs are investors
- Continuing Company LPs become JV members, with liquidity rights at stated intervals, based on prescribed valuation methodology, and subject to maintaining each IG’s ownership at <50% during the investment period
- It should be possible to structure transaction as tax-deferred for continuing Company LPs
  - Funds rolled up into JV
  - FGs purchase interests from tendering JVs
    - Structure will address FIRPTA considerations to IGs of these transactions
    - JV contributes all assets to REIT
- Discuss impact of allocated liabilities
Select Alternative Structures

**US REIT IPO**

### Topics for Discussion
- IPO proceeds can buyout GPs/LPs with flexibility of ongoing liquidity in a tax-efficient manner or can retire debt
- Management becomes internalized (founders as employees or Board members)
- Consider formation and listing costs
- Consider ongoing reporting requirements
- Discuss access to additional capital (line of credit and follow-on equity as “dry powder”)
- Consider REIT requirements: distributing income, limitations on asset sales, etc.

### Structural Considerations
- Public Investors can be US or non-US
- Continuing Company LPs become Operating Partnership unitholders, with customary rights to exchange units for REIT Shares in the future
- IPO proceeds can be used in part to buy out some existing Company LPs
- IPO proceeds also may be used to partially redeem some existing Company LPs
  - Cash generally taxable unless an exception to disguised sale treatment exists
  - Reimbursement of limited pre-formation capital expenditures
- IPO proceeds also may be used to retire existing debt
  - Potentially taxable as a disguised sale unless liabilities are “qualified”
- Tax-deferral should be possible for continuing Company LPs with no disguised sale treatment
  - Gain recognized when LPs exchange OP units for REIT shares
  - Gain recognized as Company Assets with deferred gain are sold and gain is specially allocated to Company LPs
  - “Tax Protection Agreements” to ensure a minimum deferral period are customary in the IPO market today
  - Discuss impact of allocated partnership liabilities
- Discuss internalizing the management platform in exchange for shares or OP units
Select Alternative Structures

**US REIT – Canadian Listing**

### Public Investors

- **Canadian Listed Trust**

### Structural Considerations

- **Public Investors can be US or non-US**
- **Continuing Company LPs become Operating Partnership unitholders, with customary rights to exchange units for REIT Shares in the future**
- **IPO proceeds can be used in part to buy out some existing Company LPs**
- **IPO proceeds also may be used to partially redeem some existing Company LPs**
  - Cash generally taxable unless an exception to disguised sale treatment exists
  - Reimbursement of limited pre-formation capital expenditures
- **IPO proceeds also may be used to retire existing debt**
  - Potentially taxable as a disguised sale unless liabilities are “qualified”
- **Tax-deferral should be possible for continuing Company LPs with no disguised sale treatment**
  - Gain recognized when LPs exchange OP units cash or public equity
  - Gain recognized as Company Assets with deferred gain are sold and gain is specially allocated to Company LPs
  - “Tax Protection Agreement” should be possible
  - Discuss impact of allocated partnership liabilities
- **Discuss internalizing the management platform in exchange for shares or OP units**
  - Is window closing on valuation ascribed to platform?
  - Lockout provisions on redemptions are getting longer
- **Discuss tax treatment of Canadian Listed Trust**

### Topics for Discussion

- Consider investor base (largely retail, non-institutional looking for yield)
- Typically an option for secondary, tertiary market assets and smaller equity raises (e.g. Milestone)
- Consider REIT regulations in both US and Canada
- Evaluate cross-currency hedging
- Consider changes/additions to management team and Board seats
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